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BEFORE THE ARIZONA CORPORATION COM

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Docket No. E-01345A-03-0437

IN THE MATTER OF THE APPLICATION  
OF ARIZONA PUBLIC SERVICE  
COMPANY FOR A HEARING TO  
DETERMINE THE FAIR VALUE OF THE  
UTILITY PROPERTY OF THE COMPANY  
FOR RATEMAKING PURPOSES, TO FIX  
A JUST AND REASONABLE RATE OF  
RETURN THEREON, TO APPROVE RATE  
SCHEDULES DESIGNED TO DEVELOP  
SUCH RETURN, AND FOR APPROVAL  
OF PURCHASED POWER CONTRACT.

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RUCO'S CLOSING BRIEF

The Residential Utility Consumer Office ("RUCO") offers this Closing Brief on the matters raised at the recent hearing regarding the Plan of Administration ("Plan") for Arizona Public Service Company's ("APS" or "Company") Power Supply Adjustor ("PSA") mechanism.

BACKGROUND

In APS's recent rate case, 22 of the parties negotiated a Settlement Agreement that included a PSA mechanism through which the Company could recover its costs of fuel and purchased power. The Arizona Corporation Commission ("Commission") held a hearing on the Settlement Agreement, and ultimately adopted Decision No. 67744, which approved the Settlement Agreement with various modifications. Both the Settlement Agreement and Decision No. 67744 required the filing of a Plan of Administration detailing how the PSA would

operate.<sup>1</sup> APS, the Commission's Utilities Division ("Staff") and RUCO jointly proposed the Plan of Administration that was attached to the testimonies of both Staff witness Barbara Keene<sup>2</sup> and RUCO witness Marylee Diaz Cortez<sup>3</sup>.

As originally negotiated in the Settlement Agreement, the PSA would account for all the costs of both fuel and purchased power, including the margins from off-system sales.<sup>4</sup> Base rates would include fuel and purchased power costs of 2.0743¢ per kWh, and the adjustor rate would initially be set at zero.<sup>5</sup> The adjustor rate would be reset each year on April 1, beginning in 2006. Each year on March 1, APS would file a report showing the calculation of the new adjustor rate to take effect the following month. The new adjustor rate would take effect automatically unless suspended by the Commission.<sup>6</sup> Customers and the Company would share the additional costs above, or savings below, the base costs of fuel and purchased power based on a 90-10 split.<sup>7</sup> Further, the annual change to the adjustor rate was limited to a 4 mils per kWh change each year.<sup>8</sup> Any amounts not recovered from customers due to this bandwidth would remain in the balancing account, and would not be subject to any further sharing.<sup>9</sup>

Because the PSA was subjected to a 4 mil bandwidth change each year, there was the possibility that the account balance could grow to inappropriately high levels. Therefore, the parties also included in the Settlement Agreement a provision that if the balance of the balancing account reached \$50 million (positive or negative), APS would be required to either file for a surcharge to recover/refund the balance, or explain why it did not believe it was

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<sup>1</sup> Decision No. 67744 at 42; Settlement Agreement at ¶ 32.

<sup>2</sup> Exh. S-2.

<sup>3</sup> Exh. RUCO-1.

<sup>4</sup> Settlement Agreement at ¶ 19(a),(f).

<sup>5</sup> *Id.* at ¶ 31, 19(b).

<sup>6</sup> *Id.* at ¶ 19(b).

<sup>7</sup> *Id.* at ¶ 19(c).

<sup>8</sup> *Id.* at ¶ 19(d).

<sup>9</sup> *Id.*

1 necessary to implement a surcharge at that time (for example, if APS believed that a future 4  
 2 mil adjustment would cause the account balance to decrease to a more reasonable level, it  
 3 might suggest that a surcharge would not be necessary).<sup>10</sup> The Settlement Agreement also  
 4 provided that APS would file monthly reports detailing all calculations related to the PSA,  
 5 beginning sixty days after the adoption of the Settlement Agreement.<sup>11</sup> Further, the prudence  
 6 of fuel and power purchases would be reviewable by the Commission or Staff at any time.<sup>12</sup>

7 After the hearing on the Settlement Agreement, the Chief Administrative Law Judge  
 8 issued a Recommended Opinion and Order that suggested several modifications to the PSA,  
 9 including capping the total amount of fuel and purchased power costs that could flow into the  
 10 PSA in a single year to \$776,200,000. At the Open Meetings on the matter, the Commission  
 11 approved further modifications to the PSA, including limiting the adjustor to 4 mills per kWh  
 12 over the entire term of the PSA, and requiring that APS file a surcharge application before the  
 13 balance of the account reached \$100 million.<sup>13</sup>

#### 15 THE PLAN'S DESCRIPTION OF PSA MECHANICS

16 The Plan describes in precise detail the mechanics of the PSA as set forth in the  
 17 Settlement Agreement as modified by Decision No. 67744.<sup>14</sup> The Plan describes the two main  
 18 aspects of the PSA—the accumulation of costs, and the recovery of those costs.

19 The Plan provides that the PSA balancing account is established on April 1, 2005,  
 20 which was the effective date of new rates under Decision No. 67744.<sup>15</sup> Each month, an  
 21 amount equal to 90 percent of the difference between the total costs of fuel and purchased  
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23 <sup>10</sup> *Id.* at 19(e).

24 <sup>11</sup> *Id.* at ¶ 20.

<sup>12</sup> *Id.* at ¶ 19(i).

<sup>13</sup> Decision No. 67744 at 17.

<sup>14</sup> Exh. S-1 at 2.

<sup>15</sup> Plan at 8; Decision No. 67744 at 41.

power and the amount recovered through base rates, less any amount collected by the applicable adjustor rate (which is initially set at zero), is posted to the balancing account.<sup>16</sup> Interest is also posted to the balancing account each month.<sup>17</sup>

The net margin from off-system sales reduces the costs that are posted to the balancing account.<sup>18</sup> This net margin is expected to be relatively small compared to the total costs in the balancing account.<sup>19</sup> To insure that the full margins of off-system sales are accounted for, Decision No. 67744 requires that a procurement review, to be completed within three years, include a review of APS's off-system sales practices.<sup>20</sup>

The annual net fuel and purchased power costs that can be posted to the balancing account are capped at \$776,200,000.<sup>21</sup> This cap applies to all such costs posted to the balancing account, regardless of which mechanism described below is used to recover those costs.<sup>22</sup>

Beginning in June 2005, the Company is required to file each month a report detailing the calculations related to the PSA.<sup>23</sup>

While unrecovered costs are tracked in one balancing account, the Plan describes two methods through which those costs can be recovered—a PSA adjustor rate and a surcharge. The PSA adjustor rate was established simultaneously with the creation of the balancing account, and was initially set at zero.<sup>24</sup> Beginning in March of 2006, and each March thereafter, APS is required to make a filing computing a new PSA adjustor rate, to become

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<sup>16</sup>

Plan at 8.

<sup>17</sup>

Plan at 9; Settlement Agreement at ¶ 19(h).

<sup>18</sup>

Plan at 5; Settlement Agreement at ¶ 19(f).

<sup>19</sup>

Tr. at 195, 221-22.

<sup>20</sup>

Decision No. 67744 at 18.

<sup>21</sup>

Plan at Attachment page 1, footnote 5; Decision No. 67744 at 17.

<sup>22</sup>

Tr. at 182, 205.

<sup>23</sup>

Plan at 10; Settlement Agreement ¶ 20.

<sup>24</sup>

Plan at 3; Settlement Agreement at ¶ 19(b).

effective automatically in the following April unless suspended by the Commission.<sup>25,26</sup> The Plan tracks Decision No. 67744's requirement that the PSA adjustor rate could change by no more than 4 mils per kWh over the life of the PSA.<sup>27</sup> As described above, collections of the PSA adjustor rate are also posted to the balancing account.<sup>28,29</sup>

The additional method to recover the accrued bank balance is the imposition of a surcharge, as a "pressure release valve" if the balancing account balance grows to an unmanageable level.<sup>30</sup> Any time that the monthly report shows that the balancing account has reached \$50 million, the Company has 45 days to either file a request for a surcharge, or an explanation why a surcharge is not necessary.<sup>31</sup> In no event shall the Company allow the balancing account to reach \$100 million prior to seeking a surcharge or surcredit.<sup>32</sup> Unlike the annual modification to the PSA adjustor rate, which can become effective without further Commission action, a surcharge can only be implemented with approval of the Commission.<sup>33</sup> Upon filing an application for a surcharge, the amount requested to be recovered from that surcharge will be excluded from the balance used to determine if the \$50 million and \$100 million thresholds have been reached.<sup>34</sup> This effectively resets the bank balance to zero, as

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*Id.*

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Any party could request that the Commission suspend the matter and hold a hearing. Tr. at 188.

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Plan at 2-3, 7; Decision No. 67744 at 17.

28

Plan at Attachment pg. 8, line 7.

29

APS witness Wheeler testified that, though the PSA adjustor rate only recovers historically-accrued balances, he believes it has a forward-looking effect because it does not recover the previously accrued balance. Tr. at 389. That is true in the case of ongoing costs that exceed the sum of base cost and the applicable PSA adjustor rate, which is currently the case. However, if the base cost plus the PSA adjustor rate exceeds the ongoing costs (which would have been more likely with the 4 mil bandwidth applied to each year's adjustor rate), the PSA adjustor rate could begin to collect a previously accrued balance.

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Tr. of Settlement Hearing in Docket No. E-01345A-03-0437, Vol. 1 (November 8, 2004) at 161; Vol. II (November 9, 2004) at 383, 388, 391-393, 409-410; Vol. VI (December 1, 2004) at 1182-85.

31

Plan at 9; Settlement Agreement ¶ 19(e).

32

Plan at 9; Decision No. 67744 at 17.

33

Plan at 3; Settlement Agreement ¶ 19(e).

34

Plan at 9-10.

required by Decision No. 67744.<sup>35</sup> The Plan also provides for monitoring of the progress of recovery of any approved surcharge.<sup>36</sup>

Neither the posting of a cost to the balancing account, nor the recovery of such a cost through the base cost, adjustor rate or a surcharge precludes the Commission from making a determination at any time that the cost was imprudent.<sup>37</sup> Any costs judged imprudent could be refunded to customers via a credit to the balancing account.<sup>38</sup>

**DECISION NO. 67744 CONTEMPLATED ONLY ONE BALANCING ACCOUNT, WHICH WOULD BEGIN IMMEDIATELY**

The Settlement Agreement uses only one term to refer to an account which holds unrecovered costs—"balancing account."<sup>39</sup> Two terms are used in the Settlement Agreement to refer to the amount of funds in that account—"PSA balance"<sup>40</sup> and "bank balance."<sup>41</sup> However, nothing in the Settlement Agreement states that there is a second account to hold any portion of the unrecovered costs.

All the parties to the Settlement Agreement that testified in this hearing agreed that the costs that exceed what can be recovered through the 4 mil bandwidth would already be in the balancing account before that bandwidth was applied.<sup>42</sup> If the balancing account identified in ¶ 19(d) was a secondary account which held only a subset of unrecovered costs (those that would not be recovered within the annual adjustor subject to a 4 mil bandwidth), the Settlement Agreement would have identified a primary account which held unrecovered costs even before

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<sup>35</sup>

At 17.

<sup>36</sup>

Plan at Attachment pg. 8, lines 10-19.

<sup>37</sup>

Settlement Agreement at ¶ 19(i); Plan at 11.

<sup>38</sup>

Tr. at 259.

<sup>39</sup>

In ¶¶ 19(d), (e) and (h).

<sup>40</sup>

In ¶ 19(f).

<sup>41</sup>

In ¶ 20(a).

<sup>42</sup>

Tr. at 29 (Rumolo), at 148-150, 210 (Diaz Cortez), at 262, 277, 285 (Keene).

1 the annual adjustor was reset from its initial level of zero. However, no other account is either  
2 named or referred to in the Settlement Agreement. The terms "bank balance" and "PSA  
3 balance" cannot be read to be such a primary account, as they use the term "balance," not  
4 "account." The ordinary meaning of the word "balance" (as used in Section IV of the  
5 Settlement Agreement) is the difference between totals of the debit and credit sides of an  
6 account.<sup>43</sup> Thus, a balance is an *attribute* of an account, but is not an account itself.

7 Decision No. 67744 similarly uses the term "bank balance" to refer to the amount of  
8 funds in the balancing account, and not as a reference to a separate account. At page 17,  
9 lines 10-12, the Decision "cap[s] the balancing account" and in the following sentence  
10 addresses the timing and manner of recovery of the "bank balance pursuant to Paragraph 19E  
11 of the Settlement Agreement." Paragraph 19(e) does not use the term "bank balance," but  
12 does use the term "balancing account" twice. The "bank balance" that could be recovered is  
13 the balance of the only "balancing account" referred to in the Settlement Agreement.

14 Further, under the terms of the Settlement Agreement, the "balancing account" must  
15 exist as of the inception of the PSA, negating any possibility that the "balancing account" is a  
16 secondary account that only comes into existence after the April 2006 adjustment is made.  
17 Clearly, some account must exist from the first date the PSA is effective to hold the balance of  
18 uncollected costs. Without such an account, there would be no way of knowing how much  
19 unrecovered cost had accrued or how to calculate the April 1, 2006 annual adjustment.  
20 Because the Settlement Agreement only identifies one account, the "balancing account," that  
21 must be the account to which all costs and recoveries will be posted.

22 In addition, Decision No. 67744 implies that the balancing account exists as of the  
23 establishment of the PSA. At page 18, the Decision indicates that fuel costs before the  
24 effective date of the PSA shall not be included in the PSA. The inference is that fuel costs

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<sup>43</sup>

See Webster's II New Riverside University Dictionary, 1984.

1 after the creation of the PSA shall be included. Any other reading would undermine the entire  
2 concept of the PSA as a mechanism to “track the changes in APS’ cost of obtaining power  
3 supplies.”<sup>44</sup> The Settlement Agreement’s reporting requirement<sup>45</sup> also suggests that the  
4 balancing account must exist from the outset of the PSA, as APS is required to report all  
5 “inputs and outputs” in the calculation of its balance.

6 Moreover, the use of the term “balancing account” elsewhere in the Settlement  
7 Agreement suggests that it exists before the April 2006 annual adjustment. In ¶ 19(h), the  
8 Settlement Agreement provides that the balancing account will accrue interest, and defines the  
9 applicable interest rate. Nothing in the Settlement Agreement, or in the record underlying the  
10 adoption of it, suggests that interest accruals do not occur before April 1, 2006. To the  
11 contrary, the only discussion of this interest provision at the hearing on the Settlement  
12 Agreement was in the context of the PSA generally, with no indication that it applied only after  
13 the first annual adjustment took place and additional costs remained that would not be  
14 recovered under the 4 mil bandwidth.<sup>46</sup>

15 Finally, APS’s statements at the Commission’s Open Meeting adopting the Settlement  
16 Agreement confirmed that the balancing account existed from the time the PSA would be  
17 effective. APS told the Commission the bank balance would be escalating significantly in  
18 2005, and that APS would likely be filing before the end of 2005 indicating that the trigger had  
19 been reached.<sup>47</sup> The bank balance could only escalate if unrecovered costs were being  
20 posted to it, and under no contemplated scenario would the annual adjustment and bandwidth  
21  
22

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23 <sup>44</sup> Quoting Decision No. 66567 (November 18, 2003) (approving the concept of the PSA) at 6.

24 <sup>45</sup> ¶ 20.

<sup>46</sup> See Tr. of Settlement Hearing in Docket No. E-01345A-03-0437, Vol. II (November 9, 2004) at 415 (discussing the possibility of the balance being negative and accruing interest for the benefit of the customers).

<sup>47</sup> Tr. of March 28, 2005 Open Meeting in Docket No. E-01345A-03-0437 at 359, 295.



1 have occurred in 2005. Thus, APS suggested that it understood the balancing account to  
2 begin accumulating a balance prior to the adjustment in April 2006.

3 Paragraph 19(d)'s discussion of the balancing account is not a complete description of  
4 the provisions relating to the balancing account. Instead, the main topic of that paragraph is  
5 the bandwidth that limits the change to the adjustor rate. The paragraph does *refer* to the  
6 balancing account, as it could be implicated by the operation of the bandwidth, but it is not a  
7 paragraph describing the account in its entirety. In fact, there is no single paragraph in the  
8 Settlement Agreement that does describe the balancing account in its entirety. Because the  
9 concept that a balancing account must exist for an adjustor mechanism to work at all, parties  
10 to the Settlement Agreement did not explicitly address that in the document.<sup>48</sup>

11 Taken in its entirety, the Settlement Agreement can only be read to say that there is one  
12 balancing account, which begins to accumulate costs upon the establishment of the PSA.  
13 APS's comments to the Commission at the time it considered the Settlement Agreement  
14 confirm that reading, as does the language of Decision No. 67744.

## 16 ANNUAL ADJUSTOR VS. SURCHARGE

17 Various features of the annual adjustor or the surcharge may cause one or the other of  
18 those mechanisms to appear a more "favorable" method through which APS could seek cost  
19 recovery. However, APS cannot avoid the annual adjustor by making repeated surcharge  
20 applications.

21 The adjustor was originally intended in the Settlement Agreement to be subject to  
22 annual adjustment each April 1, with each adjustment subject to a 4 mil bandwidth. The  
23 Commission's modification to make the bandwidth apply over the term of the PSA could result  
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<sup>48</sup> Tr. at 198.

1 in there being only one such adjustment, if it was in the amount of 4 mils and costs did not  
2 subsequently fall to a level permitting it to decrease.

3 The Settlement Agreement put no restrictions on how often surcharges might take  
4 place. While nothing prohibited APS from seeking a surcharge at any time, the Settlement  
5 Agreement established a presumptive trigger of a balance of \$50 million in the balancing  
6 account. Decision No. 67744 further fixed an absolute trigger of \$100 million. However,  
7 during the Open Meeting in which the \$100 million cap was adopted, three Commissioners  
8 indicated that they did not intend that cap to result in an automatic disallowance of amounts  
9 above that level.<sup>49</sup> In addition, the language of Decision No. 67744 provides that after seeking  
10 a surcharge to recover a bank balance of between \$50 million and \$100 million, the bank  
11 balance would be reset to zero unless otherwise ordered by the Commission.<sup>50</sup> Such a  
12 provision would be unnecessary if the Commission were only intending to permit the Company  
13 to seek one surcharge and requiring it to forego recovery of all other costs not recovered  
14 through the base rate plus a 4 mil adjustor. Therefore, the Plan provides that the Company  
15 could seek more than one surcharge.<sup>51</sup>

16 Nothing in the Settlement Agreement nor Decision No. 67744 prevents the Company  
17 from requesting, or the Commission from implementing, a surcharge prior to the first automatic  
18 adjustment in April 2006. As discussed above, ¶ 19(d) does not defer the recording of costs to  
19 the balancing account until after the automatic adjustment has occurred. Instead, ¶ 19(e)  
20 requires that, *any time* the account balance reaches the \$50 million level, APS must either file  
21 for a surcharge or indicate why it is not doing so. Decision No. 67744's creation of the \$100  
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23 <sup>49</sup> See Tr. of March 28, 2005 Open Meeting in Docket No. E-01345A-03-043, pgs. 241-42 (Hatch-Miller),  
24 <sup>50</sup> 271 (Spitzer), 276 and 279 (Mundell).

<sup>51</sup> Decision No. 67744 at 17.

Plan at 10.

1 million cap on the balance in the account says nothing about the timing of a surcharge  
2 application relative to the timing of an annual adjustment. It only speaks to timing of the  
3 surcharge in relation to the number of dollars in the balancing account. Further, at the Open  
4 Meeting at which Decision No. 67744 was adopted, APS indicated to the Commission that it  
5 expected to incur a \$50 million balance prior to April 2006.<sup>52</sup> However, neither the Settlement  
6 Agreement nor Decision No. 67744 requires the Commission to approve a surcharge  
7 application.<sup>53</sup>

8       Given that APS is entitled to seek a surcharge prior to April 2006 and that the 4 mil  
9 bandwidth would limit recovery through the annual adjustor mechanism, it may seem as  
10 though APS could merely request surcharge after surcharge, never passing costs through the  
11 annual adjustor. However, APS would not be excused from making its March 2006 filing for a  
12 change to the adjustor in April 2006 if it is granted a surcharge prior to March 2006. Paragraph  
13 19(b) requires APS to submit calculations of new adjustor rates each March. If, by obtaining a  
14 surcharge, that calculation resulted in a decrease to the adjustor, that decrease would take  
15 effect automatically the following month.<sup>54</sup>

## 17 CONCLUSION

19       The Plan of Administration proposed by APS, RUCO and Staff accurately embodies the  
20 terms of the PSA established in Decision No. 67744, and it merits approval by the  
21 Commission.

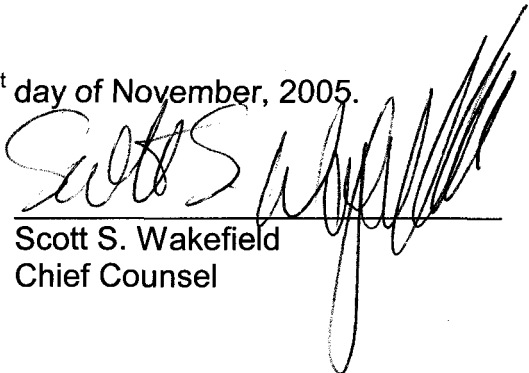
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52 Tr. of March 28, 2005 Open Meeting in Docket No. E-01345A-03-0437 at 283-84.

53 Tr. at 156; Tr. of March 28, 2005 Open Meeting in Docket No. E-01345A-03-0437 at 295.

54 Tr. at 186-87.

1 RESPECTFULLY SUBMITTED this 21<sup>st</sup> day of November, 2005.

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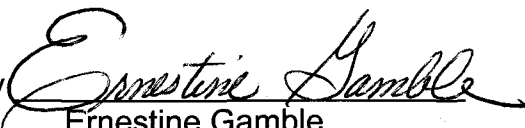
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